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ECONOMIC OUTLOOK

Chamber of Commerce of the United States

May/June 1987

NO SIGNIFICANT CHANGE IN THE OUTLOOK DESPITE FIRST QUARTER NUMBERS

Nineteen eighty-seven began with a bang, but it was a bang without much fireworks. The impressive 4.3 percent increase in first quarter real GNP was the strongest quarterly growth rate since the second quarter of 1984. Unfortunately, despite the strength, the first quarter number is not one to feel particularly encouraged about. The 4.3 percent surge was largely due to an almost $60 billion swing in real business inventories which, given a 2.2 percent decline in real final sales, can be assumed to be almost entirely unintended. The inventory swing contributed 6.6 percentage points to the increase in real GNP. (A large portion of the rise in inventories was accounted for by a $20.8 billion swing in government surplus commodity purchases. But adjusting for this, the increase in inventories was still substantial, accounting for the entire increase in real GNP.) The only other positive contributor to the nation's output of goods and services was a sharp increase in real net exports; every other component – consumer spending, business fixed investment, residential investment – posted quarterly declines, some of which were quite substantial.

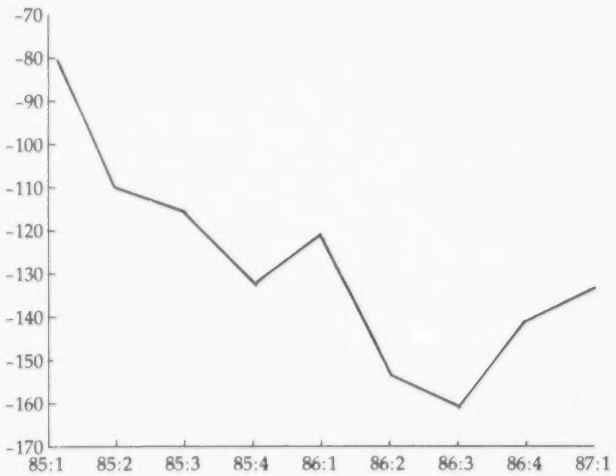
The sharp increase in inventory accumulation in the face of declines in final sales does not bode well for the second quarter. Unless domestic demand picks up significantly, anticipated inventory changes will make a negative contribution to GNP in the second quarter. For example, we expect an $18 billion increase in real business inventories; however, the swing in inventories, from $31 billion in the first quarter to the projected $18 billion in the second, makes a $13 billion negative contribution to GNP.

The news on the trade front is mixed. Both exports and imports fell during the first three months of this year, but imports fell a lot faster than exports, resulting in a narrowing of the trade deficit. This is not a pattern that we would like to see continued (i.e., we would rather see the trade gap narrow due to faster export growth), in spite of the fact that it would yield declines in the net trade deficit, because declines in trade flows are indicative of weakness in the world economy. But while concern about the nominal merchandise trade gap continues, the trade deficit on both goods and services adjusted for inflation (that is, real net exports), appears to have peaked in the third quarter of last year and shows a $29 billion improvement since then. This improvement is made up of a 3.5 percent increase in exports and a 3 percent decline in imports. This is the good news; real net exports made significant contributions to real GNP growth during the last two quarters.

CHART 1

REAL NET EXPORTS ARE IMPROVING

(BILLIONS 82$)



Unfortunately, legislators have concentrated their attention on the merchandise trade deficit, failing to appreciate

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TABLE I
UNITED STATES ECONOMIC OUTLOOK 1987-1989
Prepared by the U.S. Chamber of Commerce
(Percent change from previous period at seasonally adjusted annual rates.)

	QUARTERS									YEARS			
	Actual		Forecast							Actual	Forecast		
	86:4	87:1	87:2	87:3	87:4	88:1	88:2	88:3	88:4	1986	1987	1988	1989
GROSS NATIONAL PRODUCT													
Real GNP	1.1	4.3	2.0	2.2	3.8	4.4	4.4	3.6	4.2	2.5	2.5	3.7	3.3
Consumption	-0.4	-0.4	3.6	2.7	1.2	2.7	2.9	2.6	3.0	4.1	2.1	2.5	2.9
Residential Investment	5.2	-7.2	4.1	-2.3	1.2	4.4	4.8	0.7	5.8	9.4	1.6	2.6	3.0
Nonresidential Investment	3.0	-12.8	3.2	4.6	3.8	9.1	8.6	7.4	4.5	-1.0	-1.8	6.6	5.5
Equipment	6.6	-9.6	5.3	6.7	5.5	9.0	9.0	7.9	4.6	4.2	2.1	7.4	5.8
Structures	-5.4	-21.0	-1.9	-0.8	-0.8	9.3	7.4	5.9	4.1	-11.6	-11.0	4.3	4.5
Exports	16.7	-1.6	8.3	9.0	9.6	12.8	13.3	11.1	10.0	2.5	6.7	11.2	8.0
Real Net Exports (82$B)	-148.0	-134.2	-132.2	-127.4	-122.0	-115.1	-109.7	-106.0	-100.9	-147.8	-128.9	-107.9	-94.6
Imports	-0.5	-11.1	4.4	2.9	3.0	4.3	6.2	5.9	4.2	10.4	1.2	4.4	4.0
Government Purchases	23.2	-17.4	1.4	5.0	12.5	-12.6	2.6	4.4	11.5	2.7	1.7	1.2	0.4
Final Sales	3.9	1.9	7.4	7.0	6.9	7.0	8.2	7.9	9.0	5.3	5.3	7.5	7.9
Change in Business Inventories (82$B)	-28.5	31.0	18.0	7.2	12.7	26.5	28.1	27.3	23.5	6.6	17.2	26.3	28.2
Industrial Production	3.3	2.5	2.6	2.9	5.9	6.3	6.5	4.7	6.1	0.5	2.5	5.4	3.9
New Car Sales (mill.)	11.5	9.4	10.0	10.2	10.5	11.2	11.6	11.5	11.8	11.6	10.6	11.9	11.2
Domestic Car Sales (mill.)	7.9	6.8	7.1	7.3	7.5	8.0	8.3	8.3	8.5	8.4	7.2	8.3	8.0
New Housing Starts (mill.)	1.70	1.81	1.72	1.72	1.70	1.79	1.79	1.80	1.87	1.82	1.74	1.81	1.82
EMPLOYMENT, WAGES & PRICES													
Civilian Unemployment Rate (%)	6.8	6.7	6.4	6.5	6.4	6.2	6.1	6.0	5.9	7.0	6.5	6.1	5.9
Compensation	2.7	2.9	3.7	4.1	4.2	4.7	4.6	4.8	4.9	3.0	3.1	4.5	5.1
Productivity	-2.2	1.9	0.3	0.8	2.1	2.0	1.7	1.0	1.5	0.7	0.4	1.6	1.2
Unit Labor Costs	5.5	0.5	3.5	3.2	2.0	2.6	2.9	3.7	3.4	2.3	2.8	2.9	3.9
Consumer Price Index	2.9	5.3	4.6	4.6	4.4	4.4	4.6	4.8	4.9	1.9	3.8	4.6	4.8
Implicit GNP Deflator	0.7	3.5	3.8	3.6	3.4	3.8	3.7	4.1	4.2	2.6	2.9	3.8	4.5
Prime Interest Rate (%)	7.5	7.5	8.0	8.0	8.0	8.1	8.1	8.2	8.1	8.3	7.9	8.1	8.0
3-mos. Treasury Bill Rate (%)	5.4	5.5	5.7	5.7	5.8	5.8	5.8	5.7	5.8	6.0	5.7	5.8	5.8
Corporate Bond Rate (%)	8.7	8.4	8.9	9.0	9.0	9.1	9.2	9.0	8.9	9.0	9.2	9.1	8.9
Real Personal Disposable Income	-1.4	4.0	0.3	1.0	1.4	4.6	1.7	1.7	2.2	2.9	1.0	2.2	2.4
Profits from Current Production ($B)[1]	196.1	217.6	196.7	192.9	196.7	211.9	217.1	220.1	223.3	197.1	201.0	218.0	229.7
GOVERNMENT FISCAL POLICY ($B)[2]													
Unified Receipts										769	836	910	972
Unified Outlays										990	1008	1069	1135
Unified Deficit										-221	-172	-159	-163

[1]After-tax corporate profits with inventory valuation and capital consumption adjustments.
[2]Unified budget figures on a fiscal year basis. FY86 data are actual.

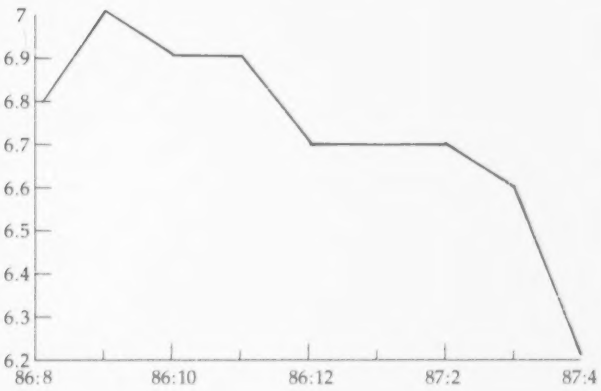
SOURCE: U.S. Chamber of Commerce, Forecasting Section, using the Washington University model of the U.S. economy.

FORECAST ASSUMPTIONS

This month's forecast contains preliminary estimates of the National Income and Product Accounts for the first quarter of 1987. The forecast incorporates provisions of the recently enacted tax reform plan. The nation's money supply M(1) is assumed to grow by 8.2 percent during 1987, 7.9 percent in 1988 and 7.3 percent in 1989. The trade weighted exchange value of the dollar falls by 12.3 percent in 1987, 1.0 percent in 1988 and stabilizes in 1989. The federal minimum wage is not expected to increase.

the improvement in real net exports during the past six months, and seemingly intent on following the protectionist path to global ruin, or at least stagnation. As we have pointed out in the past, the evidence of a turnaround in exports already exists. The decline in the value of the dollar has improved the competitiveness of American exports. One telling bit of evidence comes from an industry which has been battered by imports—steel. USX has just reported a shipment of steel to Japan, and the company's chairman has been quoted as saying that "the nation's steel industry is now in a good position to increase export shipments." However, we cannot expect a significant resurgence in U.S. exports as long as the world economy remains stagnant, and on that front, the news is far from encouraging.

CHART 2
CIVILIAN UNEMPLOYMENT PLUNGED IN APRIL
(PERCENT)



Given the weakness in demand from our major trading partners—Japan, Western Europe and Latin America—we are not likely to see a dramatic turnaround in export growth this year. Although a continuation of the improvement that we have been experiencing since mid-1986 can be expected.

* * *

Consumer spending should show an improvement following two quarters of decline; however, the increase for the year as a whole is expected to be only 2.1 percent compared to a 4.1 percent rate of increase during 1986. The onset of spring has evidently been accompanied by an improvement in consumer sentiment. The Conference Board reports that its consumer confidence index reached its highest level in 15 months in March, and despite a falloff in April, remains at a level that has historically been associated with reasonable growth rates in spending. Personal income increased quite substantially during the first quarter, showing a 4 percent gain on an after-tax, inflation-adjusted basis. This gain reflects improvements in employment as shown by continued declines in the unemployment rate, which fell to 6.3 percent in April. Indeed, labor demand may be picking up after a prolonged period of stagnation. The March index of help-wanted advertising reached a seven-year high.

The housing sector presents a mixed picture and may be the source of weakness in coming months. First quarter figures show a 100,000 unit rise in new housing starts, yet the GNP data show a 7.2 percent decline in residential investment. That weakness, however, was heavily concentrated in the "additions and alternations" component of residential construction. Yet the sharp rise in mortgage rates of the past few weeks is likely to take its toll on the housing market. We expect that housing starts will fall back to a level consistent with demographic and replacement demand, that is, about 1.7 million units per year. However, such a projection assumes that mortgage rates do not keep rising. In the coming months, we may well see a significant overreaction to the current spike in mortgage rates.

Reflecting the changes in the tax law which reduced certain investment incentives, business fixed investment fell sharply in the first quarter, led by a 21 percent drop in investment in nonresidential structures. Yet there is some evidence of improvement. New orders of manufactured goods rose by 3.4 percent in March, following a 6.7 percent advance in February. Admittedly, the gains followed a 9.8 percent tumble in January, but after the erratic swings of December and January are averaged out, it is apparent that nonmilitary orders have been accelerating, rising by 2.9 percent during the first quarter. Moreover, the National Association of Purchasing Managers survey shows that industrial activity picked up a bit more in April. The forecast calls for an improvement in the durable equipment component of investment for the remainder of this year, yet continued declines in nonresidential structures means that the business investment sector will post a 1.6 percent decline this year, following a 1 percent falloff in 1986. Investment in nonresidential structures is not expected to rise during 1987 as the sector is negatively affected by both the less generous treatment of depreciation embodied in the new tax code and the continuing adjustment to high vacancy rates in commercial and office buildings.

Prospects for 1988 are significantly better since the final phase of the personal and corporate tax rate reduction will go into effect in January. Yet the strength of the economy next year depends significantly upon three factors: (1) that the tax cut will be implemented as expected, (2) that interest rates do not rise further, and (3) that export growth strengthens significantly. While the risks appear to be on the downside, we expect 1988 to be better than this one.

TABLE II
TRENDS IN COMMERCE

	Current Period		Previous Period	Year Ago	Percent Change From Previous Period	Percent Change From Year Ago
Population (millions) [a]	Mar/87	243.0	242.9	240.9	[c]	0.9
Gross National Product ($B)	I/87	4,339.2	4,258.7	4,149.2	1.9	4.6
Gross National Product (82$B)	I/87	3,735.2	3,696.1	3,655.9	1.1	2.2
Money Supply (M1) ($B)	Mar/87	739.2	737.2	640.5	0.3	15.4
Money Supply (M2) ($B)	Mar/87	2,825.6	2,821.5	2,598.9	0.1	8.7
PEOPLE AND THEIR MONEY						
Personal Consumption Expenditures ($B)	Mar/87	2,882.6	2,873.7	2,705.9	0.3	6.5
Personal Consumption Expenditures (82$B)	Feb/87	2,460.0	2,408.9	2,377.5	2.1	3.5
Disposable Personal Income ($B)	Mar/87	3,086.9	3,075.4	2,947.8	0.3	4.7
Disposable Personal Income (82$)	Feb/87	2,632.6	2,593.3	2,583.0	1.5	1.9
Personal Savings Rate (%)	Mar/87	3.4	3.4	5.4	0.0[b]	−2.0[b]
Civilian Employment (millions)	Apr/87	111.8	111.4	109.0	0.4	2.6
Civilian Unemployment Rate (%)	Apr/87	6.3	6.6	7.1	−0.3[b]	−0.8[b]
Average Hourly Earnings	Apr/87	$8.88	$8.90	$8.72	-0.2	1.8
Consumer Price Index (All Urban, 67 = 100) [a]	Mar/87	335.9	334.4	326.0	0.3	3.0
Prime Interest Rate (%) May 5, 1987	May/87	8.0	7.5	8.5	0.5[b]	−0.5[b]
Retail Sales ($B)	Apr/87	125.4	125.2	118.4	0.1	5.9
SERVICES SECTOR						
Employment in Services (millions)	Apr/87	77.3	77.0	74.7	0.4	3.5
Consumer Purchases of Service ($B)	Mar/87	1,513.9	1,509.3	1,417.8	0.3	6.8
Consumer Purchases of Service (82$B)	Feb/87	1,205.8	1,197.9	1,168.8	0.7	3.2
Domestic Revenue Passenger Mileage Flown						
Major Airlines (billions) [a]	Mar/87	28.8	23.2	25.5	24.1	12.9
BUSINESS PROFITS AND OUTPUT						
Corporate Profits and Cash Flow ($B)						
Before Tax	IV/86	259.6	240.4	235.8	8.0	10.1
Profits Tax Liability	IV/86	115.1	104.4	96.4	10.2	19.4
Tax Liability as a Percent of Profits	IV/86	44.3	43.4	40.9	0.9[b]	3.4[b]
After Tax	IV/86	144.5	135.9	139.4	6.3	3.7
Net Cash Flow	IV/86	399.2	384.3	389.4	3.9	2.5
Industrial Production (77 = 100)	Mar/87	126.7	127.1	123.6	−0.3	2.5
Capacity Utilization Rate (Mfg.) (%)	Mar/87	79.2	79.7	79.0	−0.5[b]	0.2[b]
New Housing Starts (thou. units)	Mar/87	1,774.0	1,833.0	1,887.0	−3.2	−6.0
BUSINESS COSTS						
Unit Labor Costs (nonfarm) (77 = 100)	I/87	171.8	172.5	165.9	0.1	1.4
Unit Nonlabor Costs (nonfarm) (77 = 100)	I/87	167.2	162.2	163.9	3.1	2.0
Producer Price Indices (67 = 100) [d]						
Crude Materials	Mar/87	287.7	288.8	281.3	−0.2	−6.7
Intermediate Goods	Mar/87	309.4	308.9	309.5	0.1	[c]
Finished Goods	Mar/87	292.3	292.3	288.0	0.0	1.5
FEDERAL SPENDING AND DEBT						
Federal Spending Index (67 = 100)	Mar/87	640.3	654.5	611.2	−2.2	4.8
Fed. Gov't Gross Debt Outstanding ($B) [a]	Mar/87	2,250.7	2,245.1	1,991.1	0.2	13.0
INTERNATIONAL TRADE						
Exports of Goods & Services ($B)	I/87	384.2	385.8	369.2	−0.4	4.1
Imports of Goods & Services ($B)	I/87	518.4	533.8	495.1	−2.9	4.7
Balance on Goods & Services ($B)	I/87	−134.2	−148.0	−93.7	−9.3	43.2
WHAT'S AHEAD?						
Index of Leading Indicators (67 = 100) [a]	Mar/87	187.5	186.8	176.4	0.4	6.3

NOTE: All data seasonally adjusted unless otherwise noted

[a] Not seasonally adjusted
[b] Percentage point difference
[c] Less than 0.05 percent
[d] Index number not seasonally adjusted, percent change seasonally adjusted